

SMALL BUSINESS

IN BOX

Remember to pick up your check

By KAREN E. KLEIN
Special to The Times

Dear Karen: How do I reasonably compensate myself during start-up?

Answer: Talk to your accountant or attorney about salary strategies and their tax implications. If you skip paydays, you are depriving your business of the basic tax deduction of owner compensation, said Bill Zimmerman, a consultant for Hartford Financial Services Group.

"If you can, set up a token salary for yourself. Review this figure periodically and raise it as you can," Zimmerman said.

Your goal is to eventually compensate yourself in keeping with standards for your industry, or better. If the business cannot pay you for a period of time, have the business write you an IOU saying you've skipped a paycheck as a loan to the company. When business improves, pay yourself back.

An alternative to a regular salary is to pay yourself whenever your business can afford it. These special payments will be taxed as regular income. Make sure that you record all such transactions, as well as any missed or token paychecks and any personal funds you channel into the business, Zimmerman said. If investors raise questions, you'll have all the documentation you need to provide answers.

Making mix tapes your business

Dear Karen: I have been making music compilations for friends who love them. Can I sell these products through a subscription service or would there be copyright problems?

Answer: Music junkies who make great mix tapes often think they'd like to turn their talent into a business. But the reality is that you'd have to have a lot of friends paying you a lot of money for this to make any financial sense, said Larry Weintraub, a former music industry executive who co-founded Fanscape Inc., which bills itself as a "new-media marketing agency."

"For each song, you'd need to pay the person who wrote the song, the publisher and the owner of the recording — usually the record company," Weintraub said.

"It would cost several hundred thousand dollars just for one song."

Technology might offer you some alternatives, however.

"If you are great at putting compilations together and people will pay you for your advice on what to buy, you can have them pay you simply for that advice. You could have people pay you a monthly fee and then you can tell them what songs to download, in what order, at a place like iTunes," Weintraub said.

"If you use services such as Rhapsody or Napster, they have features where you can create playlists and then share them with other people. Both services often offer incentives or commissions when you bring in new subscribers."

Putting your kids on the payroll

Dear Karen: I've heard that I can hire my kids to work in my business. Is this legal?

Answer: You can put your child on the payroll of your business for performing copying, filing, typing, cleaning services or other tasks that he or she is capable of performing and that you'd pay someone else to do if your child were not available, said Salim Omar, a New Jersey tax and financial educator.

"In 2007, a child can earn up to \$5,150 and pay no federal income taxes on the earnings because of the standard deduction," Omar said. "Your business can deduct wages paid to your child, provided the amount is reasonable and for bona fide work."

If your business is not incorporated, you won't have to withhold FICA (Social Security and Medicare) payroll taxes on the earnings of a child younger than 18.

Got a question about running or starting a small enterprise? E-mail it to ke.klein@latimes.com or mail it to In Box, Los Angeles Times, 202 W. 1st St., Los Angeles, CA 90012.

SMALL-BUSINESS REPORT

State meets key contracting goal

By CYNDIA ZWAHLEN
Special to The Times

California small businesses won more than 25% of the \$9.5 billion in contracts the state issued in the last fiscal year, officials said, marking the first time in three years the state has met its goal to award at least one-quarter of its contract dollars to small operators. Small-business leaders applauded the accomplishment, which is expected to be officially announced next month.

"It's great news," said Randall D. Martinez, co-chairperson of the Small Business Council, an advisory group for the state and chief operating officer for Cordoba Corp. of Los Angeles, an engineering and construction management company.

More dollars for small firms can mean more tax dollars for California, he said. It also can mean more jobs for Californians.

Despite the benefits to boosting small-business participation in state contracts for all sorts of goods and services, the long-standing goal hasn't often been met.

This "is one of the very few times since [the state] started tracking this in the '90s," said Eric Mandell, head of the small-business office at the Department of General Services, which oversees small-business contracting efforts at state agencies.

The federal government, which has a 22% small-business contracting goal, also has had trouble meeting its mandate.

Details of each state agency's performance for the fiscal year that ended June 30 and the exact overall small-business participation rate are outlined in a report that has been submitted by the department to the governor's office for approval before it is released. That could happen as early as next week.

The 25% goal — which translated to about \$2.4 billion in contracts awarded to small firms in the fiscal year that ended June 30 — is meant to fuel the state's smallest businesses, which many consider to be the engines of the state economy.

Small businesses, defined by



Cordoba Corp.

GOOD JOB: "It's great news," Randall D. Martinez, co-chairperson of the state's Small Business Council, said of a report that California had fulfilled its annual goal of awarding 25% of its contracts to small firms. The long-standing goal hasn't often been met in the past.

California as those having 100 or fewer employees and average annual revenue of \$10 million or less over the most recent three years, total about 1 million firms, or 98% of all businesses.

They employ about 6.8 million people, which is half of the non-farm workforce.

Martinez and Mandell credit the state's improved numbers to a push from the top.

In an executive order issued last year, Gov. Arnold Schwarzenegger reiterated the state's intention to meet or exceed the 25% goal. He required agencies that miss the goal to devise action plans to close the gaps. And he directed the Department of General Services and his small-business advocate appointee (since May, the office has been filled by Marty Keller, a former director of an automotive business trade group) to increase efforts to help the state's smallest firms learn how to take advantage of contracting opportunities.

State and Consumer Services Agency Secretary Rosario Marin has been another driving force, Mandell said, by taking up the small-business goal "as a personal cause" and meeting with other agency secretaries to underline its importance.

"As with anything, executive

support is critical," said Mandell, who also manages the Disabled Veteran Business Enterprise office.

The Department of General Services is required to compile contract data from each agency into an annual report to the Legislature by Jan. 1.

The report for the 2006 fiscal year, which wasn't issued until last March, showed that agencies that reported their numbers awarded about 18% of their contracting dollars to small businesses, missing the goal by about 7 percentage points.

Agencies also are required to report how well they do in meeting the state's goal to award at least 3% of contract dollars to firms owned by veterans disabled during military service. An estimated 80% of those companies qualify as small businesses.

The state missed that goal for the 2007 fiscal year, with a participation rate of 2.5%, Mandell said. That's slightly higher than the previous fiscal year, when it was 2.42%. In fiscal 2005, just 1.72% of state contract dollars were awarded to firms owned by disabled vets.

In addition, California tracks how many state contracting dollars go to micro-businesses — those with 25 or fewer employees — though there is no formal goal

for that group. These tiny firms are included in the state's small-business contract figures.

Small-business participation for fiscal 2007 was helped in part by a streamlined certification process announced in January. The application to be certified by the state as small was slashed from 20 pages to a single page. And the process was moved online. Months of backlogged paper applications have been cleared up and participation has jumped.

The number of certified small businesses in the state's database has soared to 15,000 from 3,000 last year, Martinez said.

An \$11-million annual deal with Office Depot is boosting small-business contract dollars to some degree. The two-year pact, announced last fall, requires the office supply giant to funnel 98% of its state orders through small businesses.

Mandell and his colleagues have been making the rounds at state agencies to help those who missed their mark learn to find the small firms they need.

In some cases, that means packaging a contract bid in a way that doesn't require a single large vendor, he said.

Mandell hopes to overcome the seesaw effect the state has experienced with its small-busi-

Small business' share of state contract dollars

Here's a look at how the state did in meeting the goal over the last five fiscal years, which for California end on June 30.

2007: More than 25%

2006: 18%

2005: 22%

2004: 30%

2003: 18%

Source: Times research

ness participation in the past, when a high year was often followed by a low year.

Participation rates can be affected by variable accounting choices. For example, when a large state agency such as the Department of Transportation reports a big, multiyear contract in a single year, small-business participation could be increased that first year but depressed in the other years of the contract. Pending budget cuts also could hamper efforts to maintain this year's success in meeting small-business goals, Mandell said.

Martinez said he would like to extend the state's efforts even further. He said he would push for legislation requiring municipal contracts funded by the billions of dollars from the state's recent large infrastructure bonds to meet the state's small-business goals. That would include the requirement that a certified small business be headquartered in California.

Otherwise, "those are tax dollars lost," he said.

After more than a decade on the recently re-energized Small Business Council and 25 years of involvement in small-firm issues, Martinez is hopeful about the changes he says are needed to boost small businesses and the state economy.

"If there is any governor that can pull off the challenge," he said, "I'm convinced it's this one."

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Test preparation firm hits on a winning formula

[Revolution, from Page C1] an unfair advantage. Basic classes from companies such as Kaplan and Princeton Review cost about \$1,000, and prices climb if students hire individual tutors, who can charge hundreds of dollars an hour.

"Kids are deluged, correctly or not, into believing that they are involved in an arms race in which their competitors are getting the best coaching money can buy," said Bob Schaeffer, public education director of Fair Test, a nonprofit that advocates for less emphasis on standardized tests. Schaeffer thinks that the test preparation companies leave less affluent students "further behind the eight ball."

Varna and Neuberg responded to such complaints by charging half their competitors' price and telling parents, teachers and students that they wouldn't turn away those who couldn't pay.

The price wasn't the only thing that was different about their new test-preparation company. They offered courses in schools, so that students wouldn't have to travel far. They tried to alleviate students' anxiety about test-taking and changed typical preparation curriculum to make students more interested in the SAT. They established online components that allowed students to check up on their practice test scores and progress online.

The pair say that Revolution Prep was successful because they looked at education as businessmen. Neuberg spent most of his career until business school as a banker, although he had tutored for Kaplan; Varna's background was in management consulting, and he had worked for Princeton Review. They say their experiences with Princeton Review and Kaplan enabled them to see the flaws of both companies.

Their methods of finding financing probably won't be held up as a case study in any business school class. Both left UCLA's Anderson School of Management tens of thousands of dollars in debt. To start their business, they applied for dozens of credit cards and paid for everything they needed, including practice tests and promotional materials, with plastic. They received turnoff notices for



GARY FRIEDMAN Los Angeles Times

FOUNDERS: Jake Neuberg, left, and Ramit Varna say Revolution Prep was successful because they viewed education as businessmen. They say the company has 10,000 student customers a year.

their phones. Varna sold his car to get more cash.

"For the first 12 months, we'd sit down and ask ourselves how much money we needed to make to keep the doors open. We'd say \$30,000, and then we'd make \$15,000," Neuberg said. They visited high schools and tried to educate guidance counselors and students about their new company, in what Neuberg calls "straight hustling" and Varna calls "straight desperation."

Nancy Leonard, an independent college counselor who was at the time a guidance counselor at Mira Costa High School in Manhattan Beach, says she remembers when "these two young, fresh-faced boys" showed up at her office pitching their company. She was accustomed to young college graduates offering their services as SAT coaches, but in a year or two, they would be gone, on to graduate school or a different job.

"I looked at them as I did everyone not named Kaplan, Princeton Review and Ivy Prep, and I told them, 'This is going right in the trash,'" she said about the material Neuberg and Varna had prepared. Leonard challenged Revolution Prep to

tutor five of her students and improve their scores. When the students' scores climbed, she agreed to mention Revolution Prep in the same breath as the big three.

Earning that kind of respect from nervous parents was not as easy.

"Getting parents to know all their options was our biggest obstacle," Varna said. They tried to emphasize that they were more approachable than the big companies and that they cared more for individual students.

They relied on word-of-mouth marketing, and they kept true to their promise never to turn anyone away — at one school, 36 of the 37 students they tutored were on scholarships.

In some cases, it was difficult to sell parents on the idea that a lower-priced course could be as good as an expensive one. Most SAT companies have convinced parents that they need to spend big for their kids to succeed.

Once students' scores started improving, though, parents started to talk.

"Word-of-mouth marketing among parents is an awesome thing," said Palma Odano, a past president of the Culver City PTA,

whose two children took courses from Revolution Prep and who started recommending the company to friends.

When their marketing efforts started to pay off in the summer of 2003, Varna and Neuberg were still working off Varna's couch. In May of 2004, they moved from Varna's spare bedroom into a small office without air conditioning in Santa Monica. By the end of the summer, they had paid off their debt.

In a few short years, their company was growing astronomically. A student of SAT vocabulary might even call it a coup.

Their competitors aren't quite sure what to think of the upstart.

Paul Kanarek, president of the Princeton Review franchise in Southern California, calls his product a "high-end service," comparing Princeton Review to a Lexus and Revolution Prep to a Toyota.

"I offered scholarships for 25 years; I just never perceived it to be a marketing opportunity," Kanarek said.

Varna and Neuberg didn't stop at SAT test preparation. They designed educational ma-

Revolution Prep

Business: Helping students prepare for college admission tests

Owners: Jake Neuberg and Ramit Varna

Employees: 40 full-time and 300 part-time workers

Headquarters: Santa Monica

Revenue: \$6 million projected for 2007

Goal: "To provide the highest-quality SAT prep classes and tutoring at a fraction of the price of our competitors."

terials and software to help students prepare for California's high school exit exam and were recently chosen by the Los Angeles Unified School District to provide 30,000 students with the materials. They're working on developing preparation materials for exit exams in other states and will start offering a Graduate Record Examination preparation course in the spring. They've also launched a separate business, Revolution Careers, that aims to connect students graduating from college with a wide range of businesses interested in hiring employees.

The two say they realize that with expansion comes the danger of being too much like their competitors — too big, too impersonal, not focused enough on their core mission of helping kids improve their SAT scores. But five years after graduating from business school, neither seems in danger of becoming a corporate stiff.

Neuberg pads around their small Santa Monica office barefoot, wearing shorts and a T-shirt. Varna pairs his T-shirt with jeans. They still share an office, which is outfitted with big red couches for meetings, a white board and a map.

And, sounding more like the college students they used to be than the businessmen they are, they still believe in the power of karma.

"If you do the right thing," Neuberg says, "people find out."

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